MEMORANDUM FOR: Mr. Casey

Roger Robinson called, just back from two weeks in Japan. He wanted to be sure you saw his article in the 22 June WASHINGTON POST which is attached, and the reaction to it from today's WASHINGTON POST.

Debbie, 1 July 86

Date

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ON PAGE C1.

WASHINGTON POST
22 June 1986

Moscow's 'Shell Game'

Soviet Bankers Use Our Money Against Us

By Roger W. Robinson Jr.

"FOLLOW THE MONEY" is the sound advice offered by John Le Carre in his novel "The Honorable Schoolboy." This simple rule can help us unravel the tangled story of how Soviet banks operate abroad.

To picture the Soviet banking operation, imagine a banker who comes to town and solicits deposits. When the banker gets the money, he transfers most of it to his home town to support industries there; he even uses some of it as collateral to support additional loans to his home town. The depositors, meanwhile, don't know where their money has gone or how it is being used.

Soviet bankers are engaged in a similar form of borrowing in western financial markets. By a deft financial maneuver, they are taking deposits from western commercial banks and creating what amounts to an estimated $10 billion reserve checking account. The West deposits the money and Moscow gets the benefit. What's more, the Soviets may be turning some of these Western deposits, on paper, into Soviet assets.

This $10 billion cash reservoir offers important advantages to the Soviets. It eases the financial strain of supporting Cuba, Vietnam, Nicaragua and Angola, which last year alone cost Moscow an estimated $4 billion in hard currency. It helps cushion the Soviets from falling oil revenues. And it allows the Soviets to boost their spending for critically needed Western imports.

Moscow's backdoor borrowing also avoids the potential political problems—and economic costs—of taking out more typical loans from western banks. (One indication of the importance is that these interbank deposits are roughly equal to projected Soviet net borrowing requirements for 1986 and 1987, which are in the range of $7 billion to $10 billion.)

Moscow's ability to tap western commercial banks in this way raises some interesting questions. Should the West allow the Soviets unqualified access to what, in financial terms, is "easy money" without the conditions and requirements of normal commercial loans? Do we need better statistical-reporting requirements to keep track of what Soviet banks do with western money? And is the West unwittingly helping the Soviet Union to finance activities that may harm Western interests?

The Soviet banking scheme begins with a basic instrument of international banking: "interbank deposits." Through its network of wholly-owned subsidiary banks in the West, Moscow has been a player in this interbank market for years. (The Soviets also place deposits in western banks, so the practice isn't entirely one-sided.)

The interbank deposit market is global in scope. It allows banks to deposit cash with one another, facilitating an efficient flow of funds and allowing banks to earn interest on their excess cash. A picture of how Soviet banks operate in this market can be drawn from financial data that Soviet-owned banks provide to the international financial community and from the statistics gathered by the Bank for International Settlements.

The western bank deposits available to Moscow through this interbank market provide the estimated $10 billion pool—roughly $5 billion deposited in Soviet-owned banks in the West and probably another $5 billion or more deposited directly with the Soviet Bank for Foreign Trade in Moscow. The Soviets can use this cash as a sort of reserve checking account, and it has important advantages over normal financing:

- Western interbank deposits in Soviet-owned banks in the West are not reported as part of the Soviet Union's total credit risk, and interbanks are not included in the gross and net debt calculations for the Soviet Union.
- Western deposits are inexpensive and, depending on the availability and cost of longer-term credits, could be below the cost of any other type of western financing.
- The flow of Western deposits can be increased easily, by adding as little as 1/16th of a percentage point to the interest rate that the Soviets pay depositing banks. The deposits also can be renewed—so that, for example, a six-month deposit can stretch to the equivalent of a multi-year loan.

Once the Soviet banks have obtained western deposits, a complicated shell game begins. Perhaps mindful of the reporting procedures of western bank regulators, the Soviets maintain their network of western banks as subsidiaries rather than branches, thereby blurring their sole Soviet ownership.

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As a result, U.S. banks' and probably other Western banks' loan and deposit exposure to each of the Soviet banks in the West is recorded as risk exposure to the countries in which the respective Soviet banks are located—not to the Soviet Union.

Western bank deposits with the Soviet Union's 100 percent-owned bank in London, Moscow Narodney Bank Ltd., for example, are reported as United Kingdom risk, not Soviet risk.

The same is true for other wholly owned Soviet banks, including Banque Commerciale pour l'Europe du Nord SA, Paris (Eurobank); Ost-West Handelsbank AG, Frankfurt; Donaubank AG, Vienna; and East-West United Bank SA in Luxemburg. Moscow Narodney Ltd. in Singapore is recorded as, in effect, a British banking entity because of the way in which its Soviet parent bank is incorporated in the United Kingdom.

The flow of funds from the network of Soviet banks in the West to Moscow is difficult to trace, particularly when the Soviets take steps to avoid western financial reporting.

For example, if Eurobank, the Soviet subsidiary bank in Paris, were to make a deposit with the Moscow-based Soviet Bank for Foreign Trade (Vnestorgbank), it would show up in western financial statistics as a French bank claim on Vnestorgbank. If the Soviets wished to evade even this level of financial reporting, Eurobank could make a loan or deposit with a cooperative bank in Bahrain, Singapore, or any number of other offshore banking centers where bank reporting is less vigorous. That bank could, in turn, transfer the money to the Soviet Union.

The statistical reporting in this instance would show a French bank claim on a bank based in one of these offshore centers, but go no further.

(Another way that money can move unreported into the Soviet Union is by crossing from West to East Germany. Intra-German financial transactions are not reported in the statistics of the Bank for International Settlements. Thus Eurobank could make a deposit in a bank in, say, Frankfurt, which could lend or deposit the money with the Foreign Trade Bank of the German Democratic Republic, located in East Berlin. The East German bank could then transfer the funds to the Soviet Union. The statistics would again show only a French bank claim on a West German bank.)

Now the Soviets are in a position to perform the cleverest maneuver of all: turning some of the Western deposits they have received abroad into what appear to be Soviet assets. The institution that manages this transformation is the Soviet Bank for Foreign Trade, Vnestorgbank.

The Foreign Trade bank is reported to have about $10 billion in deposits with western banks. This $10 billion figure is, in turn, subtracted by western analysts from the Soviet Union's gross debt of $25 billion to $28 billion to yield a debt figure of between $15 billion and $18 billion, a measure used to help gauge creditworthiness. The question is how much, if any, of that estimated $10 billion in reported Soviet deposits in western commercial banks represents, in reality, recycled western funds? To put it more simply, how much of that estimated $10 billion that Vnestorgbank deposits in the West may, in fact, be western commercial bank money?

It's impossible to say how much without auditing the books of Vnestorgbank. But an educated guess is about $2 billion.

This is not an argument for cutting off western financing or discontinuing interbank activity with potential adversaries—only that financing and the availability of interbank deposits should be better disciplined.

In the case of interbank deposits, American and other western commercial banks should be requested to aggregate their interbank exposure to all Soviet-owned banking entities, including those in the West, and periodically to report these aggregate exposures to their respective government regulatory agencies. It would also be prudent to ensure that western deposits with the Soviet Union and other potential adversaries are not, in effect, renewed repeatedly, which tends to allow the use of these deposits to substitute for other more visible and appropriately priced financing.

In sum: The voluntary adoption by western banks of sensible guidelines concerning interbank deposits and other forms of untied lending to the Soviet Union and its clients would reduce the availability of financial resources that could be used to harm western interests. This isn't economic warfare. Financing for specific western trade transactions and projects with the Soviets can continue unimpeded. It's simply an effort to restrain the Soviets from shrewdly tapping the international financial system in ways that ultimately may hurt the West.

Roger Robinson, the president of RWR Inc., was senior director for international economic affairs for the National Security Council from 1982 to 1985. This article is adapted from a longer version that will appear in "The National Interest."

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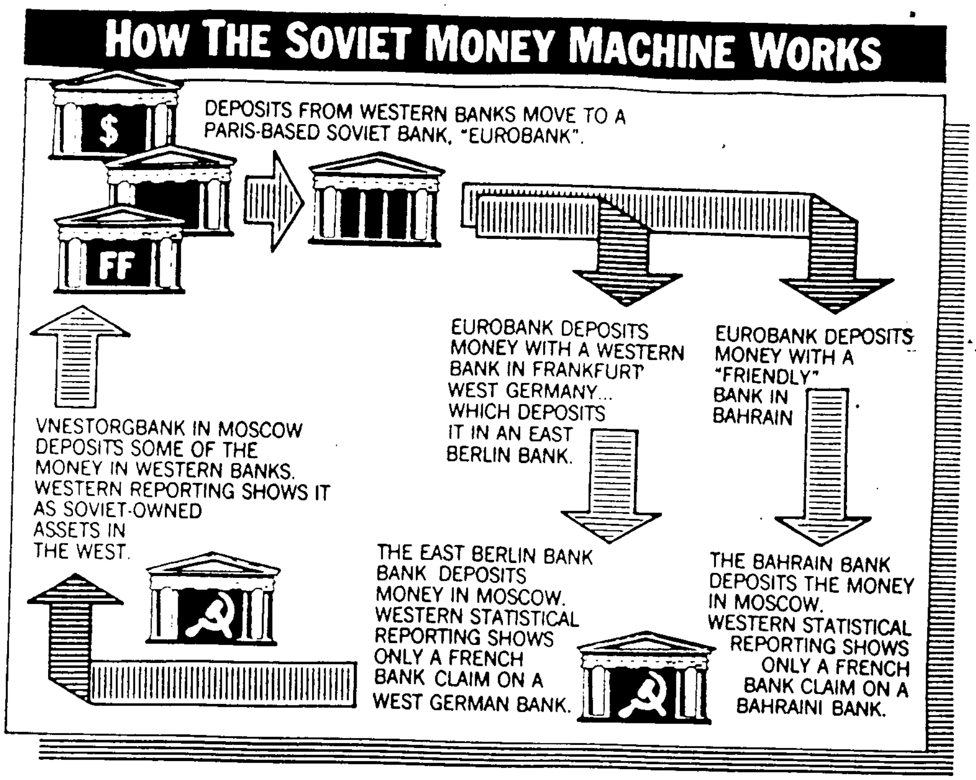

THE WASHINGTON POST

THE WASHINGTON POST
1 July 1986

Banking With the Soviets

Roger W. Robinson Jr.'s article, "Moscow's Shell Game" [Outlook, June 22], raised a mostly hidden but vital issue that goes beyond international banking—namely, to what extent shall we finance the Soviet Union's activities and policies?

As an American participant at the Bern Conference for Helsinki Review in April, I must say that we explored this issue in some depth. The conference's concluding documents recommended that any further financing of the Soviets' military machine under the guise of trade should wait for compliance with the peace promises made in the Helsinki Final Act. It was not our purpose by this to discourage trade but rather to encourage compliance.

There are obligatory reasons for this:

The accords require us to enforce its provisions, or we may be found in violation of the enforcement provisions ourselves.

Further, the Soviet Union will not have in the foreseeable future the foreign exchange (from exports) to pay for such trade. So unless American businesses will accept rubles (a non-traded currency) for payment, trade will be financed by American government/taxpayer-guaranteed banks. Obviously, dollars are printed in the United States, not in Moscow. Therefore, this results in a de facto gift to the Soviets. Is this the best use of a gift from the American taxpayers, or are American cities, farms and families more deserving?

If such gifts are to be made to other nations, shouldn't they be given to governments which comply with accords they sign, such as Helsinki, and not to those which use our funds to build missiles pointed at our children or to build tanks to roll over the people of Afghanistan?

We owe a great debt of gratitude to Roger W. Robinson Jr. for opening the door a little so that light may shine on the dark, secretive world of American financing of the expansion and aggression of the Soviet Union.

MARTIN COLMAN
Washington